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RUCPDO/DEPT OF COMMERCE WASHDC
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SIPDIS

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DEPT FOR EAP/MTS AND EB/IFD/OMA
TREASURY FOR IA-SETH SEARLS
SINGAPORE FOR BAKER
COMMERCE FOR 4430/BERLINGUETTE
DEPARTMENT PASS FEDERAL RESERVE SAN FRANCISCO FOR FINEMAN
DEPARTMENT PASS EXIM BANK

E.O. 12598: N/A

TAGS: [EFIN](#) [EINV](#) [ECON](#) [PGOV](#) [ID](#)

SUBJECT: INDONESIA - ECONOMIC AND FINANCIAL HIGHLIGHTS FEBRUARY
2007

11. Summary. Despite economic disruption due to severe flooding in Jakarta February 2-11, month-on-month (MoM) consumer price inflation in Indonesia rose modestly by 0.6% in February 2007, or 6.3% year-on-year (YoY). In response, Bank Indonesia (BI) cut its benchmark 30-day BI Certificate (SBI) interest rate by 25 basis points (bps) to 9% on March 6, the lowest rate since September 2005.

Along with other emerging markets, Indonesia experienced significant currency volatility in late February and early March 2007, with the rupiah depreciating 1.7% over the period. The Government of Indonesia (GOI) raised a total of Rp 17.4 trillion (\$1.9 billion) from domestic debt swaps and bond auctions in January and February 2007. On February 7, the GOI issued \$1.5 billion of dollar-denominated 30-year global bonds, yielding 6.75%. Ratings agencies Fitch and Moody's raised Indonesia's sovereign rating outlook from stable to positive on January 29 and February 4 respectively. After numerous delays in its privatization program, the GOI submitted to Parliament on February 12 a list of state-owned enterprises (SOEs) for partial privatization. On February 16, the State Minister for State-Owned Enterprises Sugiharto installed new boards of Directors and Commissioners at state pension company Jamsostek, Indonesia's largest pension fund with Rp 31 trillion (\$3.4 billion) under management. This report uses an exchange rate of 9,160 per dollar. End summary.

Benign Inflation Data Leads to BI Rate Cut

12. On March 1, the Central Bureau of Statistics (BPS) announced that the Consumer Price Index (CPI) rose modestly by 0.62% in February 2007, or 6.3% YoY, lower than expected. The benign inflation data surprised analysts, many of whom believed severe flooding in Jakarta February 2-11 would cause a jump in February inflation. Although February food inflation reached only 0.84% MoM, BPS data showed a 7.8% increase for the grains subgroup. Prices for other food subgroups declined, including spices, which fell by 8.17%. Rice prices (medium quality) have increased by around 14% since the beginning of 2007 and in early March are approximately 35% higher than the government's desired price level. Government officials reportedly said price increases have slowed due to the Government's decision to import 500,000 tons of rice between March and April this year.

Table 1: Consumer Price Inflation Components
January - February 2007

Component	January		February	
	MoM	YoY	MoM	YoY
Foodstuffs	2.7	11.2	0.8	10.8
Prepared food, beverages, tobacco	0.9	6.3	0.7	6.3
Housing, water, electric, fuel	0.7	4.9	0.8	5.1
Clothing	-0.3	5.8	0.6	5.6
Health	0.5	5.3	0.6	5.6
Education, recreation/sports	0.1	8.0	0.2	8.6
Transportation, communication and financial services	0.1	1.2	0.0	1.0
Total	1.0	6.3	0.6	6.3
Core Inflation (1)	0.7	6.1	0.6	6.0

(1) Core inflation excludes cdrpi(tems that face volatile price movements i.e. energy, fond r"odc"ts.

Source: Central Bureau of Statistics (BPS)

13. On February 6, Bank Indonesia (BI) cut its benchmark 30-day SBI rate by a 25 basis points to .25%, stating that inflation is "stabilizing" ataapproximately 6.1%. In light of the lower-than-x(pected February inflation, BI cut its 30-day SBI aate by another 25 bps to 9% on March 6, the lowest level since September

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Indonesia Weathers Emerging Market Volatility

14. Along with other emerging markets, Indonesia experienced significant capital market volatility in late February and early March 2007. The rupiah came under pressure in the last week of February 2007, with the currency's largest one day decline occurring on February 28, when it fell 0.9% from Rp 9,070/USD to Rp 9,160/USD. It continued to drift lower in early March, closing at Rp 9,220/USD on March 16. Over the February 20 - March 16 period, the rupiah declined by 1.7% against the dollar. The Jakarta Stock Exchange's (JSX) composite index went on a bumpier ride, declining 6.9% from February 21 - March 5. On March 5, the JSX came under heavy selling pressure along with other countries in the region, with the composite index falling by 3.6% during the day to 1,699. However, it bounced back by 1.9% on March 6, and as of March 16 stood at 1,778, representing an overall decline of 2.2% from February 20 - March 16.

Government Debt Market Update

15. On January 9, the Ministry of Finance (MOF) raised Rp 1.6 trillion (\$175 million) from swapping rupiah bonds maturing 2007-2011 for 19-year bonds priced to yield 10.2%. A subsequent bond buy-back on January 30, at which the MOF offered to swap bonds maturing 2008-2012 for 20-year debt, met with a good response, raising Rp 5.9 trillion (\$644 million). The 20-year bonds were priced to yield 10.5%. A February 13 debt swap was less successful, with the GOI raising only Rp 1.1 trillion (\$120 million) from swapping bonds maturing in 2008 with 20-year bonds.

16. The GOI raised a total of Rp 8.8 trillion (\$961 million) from bond auctions on January 23 and February 20. At the January 23 auction, the MOF sold Rp 4.8 trillion (\$524 million) of bonds maturing in 2027 at a 10.5% yield. On February 20, the MOF sold Rp 4 trillion (\$437 million) of 15-year bonds priced to yield at 10.7%.

Table 2: GOI Debt Swaps and Auctions
January - February 2007 (in Rp trillion)

2007 target		66.7
January 9	Swap	1.6
January 23	Auction	4.8
January 30	Swap	5.9
February 13	Swap	1.1
February 20	Auction	4.0
TOTAL		17.4

Source: Ministry of Finance

Investors Snap Up Indonesian Sovereign Bonds

17. On February 7, the MOF issued \$1.5 billion of dollar-denominated global bonds, Indonesia's fifth global bond offering since 2004. The bonds will mature in 2037 and offer a 6.75% yield. According to Bank Indonesia, 38% of the buyers were Asian, 37% came from the United States, and 25% came from Europe. Standard & Poor's gave the bonds a "BB-" rating, four steps below investment grade, while Fitch Ratings and Moody's Investor Service rated the bonds "B1". The offering was noteworthy for being the largest 30-year dollar bond issuance by a Southeast Asian issuer to date, and for being priced at 189 bps over the 30-yr U.S. Treasury rate, the tightest spread of any Indonesian global bond offering to date.

Table 3: Indonesia - Global Bond Yields
2004 - 2007

Date	Amount/Tenor	Yield
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March 2004	\$1 bill/10 yr	6.85%
April 2005	\$1 bill/10 yr	7.375%
Oct. 2005	\$900 mill/10 yr	7.625%
	\$600 mill/30 yr	8.625%
March 2006	\$1 bill/11 yr	7.00%
Feb. 2007	\$1.5 bill/30 yr	6.75%

Source: Ministry of Finance, Bloomberg

Fitch and Moody's Upgrade Indonesia

18. On January 29, Fitch Ratings revised the outlook on Indonesia' foreign and local currency ratings from stable to positive, while affirming both ratings at "BB-". The agency also affirmed Indonesia's short-term default rating at "B" and the country ceiling at "BB". According to a Fitch statement, the revision of Indonesia's sovereign ratings "reflects the GOI commitment to maintaining economic stability and fiscal discipline, as well as the Government's stronger top-down implementation of structural reforms aimed at improving the investment climate." Fitch forecasts Indonesia's fiscal deficit will stay manageable at 1.1% of GDP this year, while the government debt-to-GDP ratio should drop to around 38%. According to the agency, "although external balance sheet risks remain, a stronger reserve position provides a cushion for shocks."

19. On February 4, Moody's Investor Service also changed the outlook on Indonesia's B1 foreign and local currency government bonds from stable to positive. Moody's noted that this "reflects the steady improvement of the government's debt position." Moody's also changed the outlook on Indonesia's Ba3 foreign currency country ceiling for bonds and the B2 foreign currency country ceiling for bank deposits to positive from stable. "The government's prudent fiscal policy is likely to continue for the next several years," said Moody's Vice President Steven Hess. "The continuation of the small deficits recorded during the last several years, combined with

fairly high nominal GDP growth, has resulted in a substantial decline in the ratio of government debt to GDP." Hess stated that, at 42% by the end of 2006, Indonesia's debt/GDP ratio is now comparable to countries with a higher rating, and that a future Moody's upgrade could result from further improvements in the government debt picture and policy reforms that improve the investment climate.

Discussion Starts on Privatization

¶10. On January 31, a GOI privatization committee chaired by Coordinating Minister for the Economy Boediono, approved 15 state-owned enterprises (SOEs) for partial privatization this year. The committee selected the 15 from a list of 24 proposed by the State Ministry for State-Owned Enterprises. The GOI submitted the list to Parliament's Commission VI during a February 12 hearing, and is now waiting for Parliament's approval.

Table 4: SOEs Submitted for Privatization in 2007

SOE	Industry	Method	GOI Shares/ to be Divested
Jasa Marga	Tollroads	IPO	100/49
BNI	Bank	SO	99/40
Wijaya	Construction	IPO	100/35
Karya			
PNM	Finance	SS	100/30
Garuda	Airline	SS	100/49
Merpati	Airline	SS	93/40
ISI	Soda ash	SS	100/100
Industri	Glass	SS	64/64
Gelas			
Cambrics			
Primissima	Textiles	SS	53/53
Atmindo	Chemicals	SS	37/37
Intirub	Tires	SS	10/10
PPLI	Waste	SS	5/5

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	Disposal		
JIHD	Property	OTC	1.3/1.3
Kertas	Paper	SS	0.8/0.8
Blapak			
KBR	Paper	SS	0.4/0.4

Source: Ministry of SOEs

Notes:

(1) IPO - Initial Public Offering; SO - Secondary Offering; SS - Strategic Sale; OTC - Over-the-counter sale.

¶11. Many analysts believe, if approved, the program could jump start Indonesia's long-stalled privatization program and lead to improved performance among the 14 SOEs. However, privatization has long been controversial in Indonesia and often meets with resistance in Parliament. There were no significant government divestments in 2005 - 2006.

Table 5: Privatization in 2001 - 2005

SOE	Divestment (%)	Rem. GOI Shares	Method	Proceeds (\$ million)
2001:				
Kimia Farma	9	91	IPO	11
Indofarma	20	80	IPO	15
Socfindo	30	10	SS	45
Telkom	12	54	Placement	302
2002:				
Indosat	8	15	Placement	104
	42		SS	608

Telkom	3	51	Placement	118
Bukit Asam	16	84	IPO	17
WNI	42	0	SS	27

2003:				
Mandiri	20	80	IPO	292
Indocement	17	0	SS	140
BRI	45	60	IPO	292
PGN	39	61	IPO	140

2004:				
Pembangunan				
Perumahan	49	51	EMBO	7
Adhikarya	25	51	EMBO	7
	25		IPO	
Mandiri	10	70	Placement	313
Bukit Asam	13	65	SO	20

Source: Ministry of SOEs

Note:

IPO - Initial Public Offering; SS - Strategic Sale; EMBO - Employee Management Buy Out; SO - Secondary Offering

GOI Installs New Boards at State Pension Company

12. At a February 16 shareholders meeting, SOE Minister Sugiharto appointed new boards of directors and commissioners for state pension company Jamsostek. Citing Jamsostek's lack of financial and investment transparency, Sugiharto gave the new management eight months to prepare a public financial performance report. The new management is reportedly looking for alternative investments to the time deposits that currently hold nearly 50% of the company's investment funds. Jamsostek investment director Indraswari Kartakusu said, "considering the current environment where interest rates are falling, I think we have to look at other instruments, in the bond and equities markets." Newly appointed President Director Hotbonar Sinaga was formerly Chairman of the Indonesian Insurance Council.

13. Jamsostek is Indonesia's largest pension fund with Rp 31 trillion (\$3.4 billion) under management, covering 6.9 million

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workers or 21% of the formal workforce. The World Bank noted in a recent report that the company essentially functions as a short-term, tax-sheltered savings scheme, as opposed to the long-term retirement income scheme that it was designed to be. Neither its insurance nor old-age benefits programs fall under applicable Indonesian laws, but rather the company functions under ad hoc government regulations under the general supervision of Ministry of Manpower. Jamsostek has been repeatedly criticized for poor investment decisions and weak governance.

Table 6: Jamsostek Boards

Position	Old Board	New Board
Board of Directors:		
President Director	Iwan Pontjowinoto	Hotbonar Sinaga
Investment	Iskandar Rangkuti	Indrasjwari
Finance	Tri Lestari	Myra Asnar
Service and Operation	Andi Achmad	Ahmad Ansyori
General Affairs and HR	Acep Jayaprawira	Rahmaniah Hasdiani

Planning, Development & Information	Tjarda Muchtar	Suyono
Risk Management and Compliance		Dewi Hanggraeni

Board of Commissioners:

President Commissioner	Prijono Tjiptoherijanto	Wahyu Hidayat
Members:	Suryo Sulisto	Myra Hanartani
	Suparmanto	Haryadi Sukamdani
	Didid Damanhuri	Rekso Silaban
	Syukur Sarto	Syukur Sarto
		Herry Purnomo

Source: Jamsostek

Table 7: Selected Economic, Financial, and Trade Statistics,
November 2006 - February 2007

	Nov	Dec	Jan	Feb
CPI Inflation (YoY)	5.27	6.60	6.26	6.30
CPI Inflation (MoM)	0.34	1.21	1.04	0.62
Rp/USD Exch. rate(1)	9,140	9,020	9,090	9,160
30-day SBI rate (1)	10.25	9.75	9.50	9.25
Foreign Res. (\$ bn)(1)	41.6	42.6	43.3	45.7
JSX Composite Index(1)	1,719	1,805	1,757	1,741

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Exports (\$ billion)	8.9	9.5	8.4
Percent change (YoY)	17.6	16.9	10.5
Imports (\$ billion)	5.9	4.9	5.2
Percent change (YoY)	6.1	5.9	19.5
Trade Balance	3.0	4.6	3.2

Source: Bank Indonesia, BPS, JSX
(1) End of period

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